

CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE

Minutes

May 14, 2009

The Capital Projects and Bond Oversight Committee met on Thursday, May 14, 2009, at 1:00 PM, in Room 169 of the Capitol Annex.

Present were:

Members: Senators Julian M. Carroll, Bob Leeper, and Elizabeth Tori; Representatives Robert R. Damron, Steven Rudy, Jim Wayne, and Susan Westrom.

Guests: Bob Wiseman and Frank Butler, University of Kentucky; Charles Bush, Division of Real Properties; Sandy Williams and John Herald, Kentucky Infrastructure Authority; Judge Henry W. Bertram, Pendleton County; Representative Tom McKee; Katie Smith, Department for Financial Incentives; Tom Howard and Brett Antle, Office of Financial Management; and Rick McQuady and Kevin Bradley, Kentucky Housing Corporation.

LRC Staff: Don Mullis, Kristi Culpepper, and Samantha Gange.

Don Mullis, Committee Staff Administrator called the meeting to order and asked the Secretary to take the roll.

Representative Damron made a motion to approve the minutes of the April 21, 2009, meeting. The motion was seconded by Senator Tori and approved by voice vote.

Next Mr. Mullis said that an election for a Senate Co-Chair and House Co-Chair was needed. Senator Carroll nominated Senator Leeper for the position of Senate Co-Chair. The motion was seconded by Senator Tori. Senator Carroll then made a motion that nominations cease and that Senator Leeper be elected Senate Co-Chair by acclamation. The motion was seconded by Senator Tori and approved by voice vote.

Representative Rudy nominated Representative Westrom for the position of House Co-Chair. The motion was seconded by Representative Damron. Representative Damron then made a motion that nominations cease and that Representative Westrom be elected House Co-Chair by acclamation. The motion was seconded by Representative Rudy and approved by voice vote.

Representative Westrom asked Mr. Mullis to discuss correspondence and information items. Mr. Mullis said members' folders contained several correspondence

items: a letter sent to the Finance and Administration Cabinet relating to the Kentucky Infrastructure (KIA) 2020 program grant to the City of Williamstown; correspondence from KIA; correspondence from the Cabinet for Health and Family Services relating to the Boni Bill; and correspondence from the Office of Financial Management (OFM) regarding questions related to the states portfolio.

Mr. Mullis also noted that members' folders contained several information items: Energy Performance Savings Contract Leases (EPSC); KIA Economic Stimulus Recovery Funding update; and the staff and bond market updates.

Representative Westrom called on Bob Wiseman, Vice President for Facilities Management, University of Kentucky (UK), and Frank Butler, Executive Vice President for Finance and Administration, UK, to discuss a report. Mr. Wiseman reported the final purchase of the Samaritan Hospital at a previously agreed upon price of \$35 million. The purchase includes almost 14 acres of land adjacent to UK campus, a hospital, a parking garage, and a medical office building. He said that the financing is a fixed-rate, lease-purchase agreement as authorized by the General Assembly in SB 143 of the 2007 Regular Session. The Committee was briefed on the acquisition on June 19, 2007 and July 24, 2007. The purchase agreement and financing were approved at the UK Board of Trustees March 10, 2009 meeting. The financing vehicle is a 20-year fixed-rate lease-purchase agreement through the Kentucky Association of Counties Leasing Trust (CoLT). [CoLT is a member service of the Kentucky Association of Counties (KACo), established in 1989 to assist in financing governmental purpose projects.]

Mr. Butler discussed some background information pertaining to the acquisition of Samaritan Hospital. He said that at the time UK sought the acquisition of Samaritan Hospital it was in the early stages of bankruptcy filing. It was in UK's interest to maintain the facility and keep the 450 employees. The number of people employed at the facility has since increased to 680. The acquisition of Samaritan has also allowed UK to provide more access to patients. Mr. Butler indicated that UK was under pressure to acquire the Samaritan Hospital because of a 90-day put option with Ventas to execute a purchase agreement.

Representative Damron asked why UK entered into a financing arrangement for Samaritan Hospital that used derivatives when UK has been very successful with fixed-rate bonds. Representative Damron also asked if UK believed they had a fixed-rate when they signed the agreement. Mr. Wiseman said that Schedule B of the lease identifies it as a fixed-rate agreement. Representative Damron said that there are provisions in the document that allow for the payments to change.

Representative Damron asked who told UK that they had a fixed-rate. Mr. Butler said that was the university's interpretation from internal discussions and discussions with KACo. Mr. Butler indicated that UK was aware that the letter of credit and

administrative expenses can rise during the lease period. Mr. Butler noted that UK is not a party to the swap agreement.

Representative Damron then asked if U.S. Bank gets downgraded, who is responsible for paying for the additional costs associated with the downgrade. Mr. Butler said that KACo would be responsible for the additional costs. Representative Damron asked if KACo has the financial standing and ability to cover the financial risk of an entity being downgraded. Representative Damron said he is concerned about swaps because of what is happening to local governments around the country such as in Tennessee. He said there is a municipality in Tennessee that was involved in a swap and officials believed they had a fixed rate. However, the rate was not actually fixed and the municipality ended up paying hundreds of thousands of dollars more than officials expected.

Representative Damron commented that he did not understand why UK would enter into a swap agreement when UK has good credit ratings, especially with all the negativity surrounding swaps. He said that he thinks UK has a lot of risk exposure that they are not identifying. Mr. Butler said that UK did not have bond authority for this acquisition and went with the best alternative given the time frame. Mr. Wiseman also commented that this issue points out the value of the bill Representative Damron has been proposing the last few sessions that would give universities the option of bringing a bond proposal to the Committee during the interim.

Representative Damron said that, understanding that there is additional risk exposure from the potential of U.S. Bank to be downgraded from its current rating, would it be possible for UK to negotiate a side agreement with U.S. Bank clarifying that UK does not have any risk exposure. Mr. Butler said UK would be willing to seek that, but he did not know if KACo would agree to it. Representative Damron said that it would make the Committee more comfortable if UK could get in writing that KACo is taking the risk.

Representative Damron said that when the lease statutes were written, \$35 million leases with 20-year terms were not anticipated. He suggested that leases exceeding some dollar figure or maturity have the same reporting requirements as bond issues. He also suggested that the Committee should consider ways to ensure that governmental entities understand the risks involved when they use derivative-based financial products.

Representative Westrom asked if UK worked with a financial advisor. Mr. Butler said that UK evaluated the financing internally and did not consult its bond counsel.

Representative Wayne asked why UK did not approach the General Assembly and ask for bonding authority in February 2009 when they knew the put option was being exercised. Mr. Butler said UK was actually notified in November of 2008 that Ventas was exercising the put option. He said UK wanted to use the lease-purchase authorization

provided by the General Assembly. Mr. Butler said that past experience with getting bonding authority from the General Assembly has not been successful. He said UK did not want to take a chance of losing the financing mechanism approved by the legislature. Mr. Wiseman commented that giving UK bonding authority would alleviate these issues.

Representative Wayne asked Mr. Wiseman if he could report back to the Committee whether or not a side agreement with KACo is reached concerning the risk exposure. Representative Wayne expressed his concerns with the financial stability of CoLT.

Representative Wayne asked who oversees CoLT. Mr. Wiseman said he thought that there was a board, but would clarify that for the Committee.

Representative Wayne asked Mr. Wiseman to report back to the Committee on the side agreement with KACo as well as who oversees CoLT.

Representative Damron commented on bonding authority. He said because of provisions in the swap agreement, terminating the agreement could be too costly and that pursuing bonding authority for the Samaritan Hospital was not a viable option. He said that the only way for UK to avoid risk exposure is to get KACo and U.S. Bank to sign a side agreement saying that UK would not be held liable for any costs other than the letter of credit. Mr. Butler said that the \$35 million lease-purchase agreement represents three percent of UK's debt.

Next, Representative Westrom asked Mr. Mullis to give a report on Murray State University (MSU) land acquisition. Mr. Mullis said that MSU has taken action on an approved project to acquire \$1 million of land in Paducah, Kentucky. No Committee action was required.

Representative Westrom asked Mr. Mullis to report on the Energy Savings Performance Contract (ESPC) for Eastern Kentucky University (EKU) due to a representative from EKU not being present. Mr. Mullis said that pursuant to KRS 56.770-56.784 enacted in 2002, ESPCs are to be reviewed and approved by OFM prior to contract executions. Under an ESPC, a contractor agrees to design, finance, install, or manage energy conservation measures in state buildings and guarantees an amount of energy savings. Mr. Mullis said as discussed in the information item from OFM to postsecondary institutions regarding ESPCs, OFM cannot approve any ESPC financing arrangement that requires a pledge of the university's general receipts on a parity basis with the institution's General Receipts Trust Indenture. EKU included this ESPC under their General Receipts Trust Indenture subsequent to OFM's review of the project. Mr. Mullis said any future ESPCs will be executed pursuant to statute. No Committee action was required.

Representative Westrom called on Charles Bush, Director, Division of Real Properties, Finance and Administration Cabinet, to report several lease modifications and a new lease. Mr. Bush said that two of the lease modifications are being reported to the Committee late. He said that to prevent this in the future he has asked staff to include language in the initiation documents that will address the Committee's reporting process. The first lease modification was for the Cabinet for Health and Family Services (CHFS) in Martin County (PR-4792). CHFS requested replacement space of approximately 12,000 square feet to accommodate 53 staff members. The cost of the modifications, \$86,701.72, will be amortized over the lease term (through June 30, 2014). The second lease modification was for CHFS in Rowan County (PR-4867). CHFS had leased space under two leases and requested approval for approximately 9,000 square feet of space that included a regional training room that would accommodate 21 work stations. The new lease is \$137,655 annually and expires June 30, 2015. The last lease modification was a transfer to Justice and Public Safety Cabinet, Department of Juvenile Justice (Department) (PR-3769) from CHFS. The Department previously occupied 4,669 square feet of leased space. The Department was required to vacate the facility because of a transfer of the property to the City of Frankfort and the lease was terminated. The Department submitted a request for permanent replacement space for nine community services staff with a need of 2,070 square feet of space. During the same period, CHFS submitted a request to terminate an existing lease of 14,740 square feet. CHFS transferred the lease to the Department, with the reduced lease space from 14,740 to 2,266 square feet. The annual rental cost reduced from \$99,495 to \$15,296 and extended the term for one additional year (through June 30, 2011). No Committee action was needed.

Next, Mr. Bush asked for approval of a new lease that exceeds an annual cost of \$100,000. He reported a new lease of office space for CHFS (PR-4948) in Jefferson County. He said the current lessor, Hurstborne Business Park Partnership, submitted the winning proposal. The new rate is \$11.75 sq. ft., or \$291,541 annually, an increase of 25.7%.

Representative Wayne made a motion to approve the lease. The motion was seconded by Senator Carroll and passed by unanimous roll call vote.

Representative Wayne asked why the lease for CHFS in Martin County increased so dramatically. Mr. Bush said that the new lease provided additional parking spaces as well as provided space in the new Fiscal Court Building to accommodate the overcrowded conditions.

Representative Westrom then called on Sandy Williams, Financial Analyst, KIA to present several loans and a grant. The first loan request was for a Fund A loan for the City of Mt. Washington (City) in Bullitt County. The City is requesting a \$10.5 million loan to expand its wastewater treatment plant from 1.3 million gallons per day (MGD) to 3.5 MGD. The project will address an agreed order with the Division of Water and will

eliminate contamination of tributaries to Floyd's Fork and the Salt River. The loan term is 20 years with an interest rate of three percent.

Representative Rudy made a motion to approve the Fund A Loan for the City of Mt. Washington in Bullitt County. The motion was seconded by Representative Damron and passed unanimously by roll call vote.

Ms. Williams next presented a Fund F loan increase for the City of Hopkinsville (City) for the Hopkinsville Water Environment Authority (Authority) in Christian County. The City is requesting a \$4 million increase to the previously approved \$4 million loan to increase the capacity of the Authority's water treatment plant from 10 to 15 MGD. These improvements will allow the Authority to meet projected demand until 2030 and comply with federal drinking water regulations. The new loan amount is \$8 million. The loan term is 20 years with an interest rate of one percent.

In response to questions from Representative Westrom, Ms. Williams said that the original loan request for the City was \$8 million. However, the KIA Board policy is that a borrower cannot receive more than \$4 million in a funding year from a capitalization grant. The City was told by KIA that they would be eligible for the additional \$4 million in the next funding cycle. Ms. Williams also said that the City has not yet issued bonds for this project.

In response to a question from Senator Tori, Ms. Williams said that the rate increase to customers is based on 4,000 gallons.

Representative Wayne asked what deductive alternatives were included in the bid package. Ms. Williams said that the deductive alternatives are the items that the water district would like to include that are not integral to the project, but will need in the future. An example is backup generators.

Representative Wayne made a motion to approve the Fund F loan increase for the City of Hopkinsville in Christian County. The motion was seconded by Representative Rudy and passed unanimously by roll call vote.

Next Representative Westrom asked John Herald, Deputy Director, KIA to present a request from the City of Williamstown (City) for a 2020 grant (Water Resources Development Bond Program) in the amount of \$548,378. [This project was also presented to the Committee in April 2009.] The grant would be used for the planning phase of the Lake Williamstown Expansion Project. The planning project would eventually lead to the construction phase for the proposed expansion of Lake Williamstown (Lake) from its current 300 acres to 1,300 acres.

Judge Henry W. Bertram, Pendleton County, came to the table for a presentation of the project. Judge Bertram said that the Lake Williamstown Project is a joint regional project of Grant and Pendleton counties. The dam's structural integrity is currently weakened, and local government has spent over \$1 million for ongoing repairs to the dam. Building the proposed dam would have significant economic impact, while constructing a new dam below the current dam or reconstructing the spillway would not have any economic impact and would cost about the same.

Judge Bertram also said that constructing the proposed dam would prevent potential dam failure, which would result in total water supply loss. The project would also eliminate potential for regional water shortages in the future and double fresh water output from 5 MGD to 10 MGD. This project will allow the region to have access to 10 MGD of clean water and could potentially serve as an alternative water source for the Northern Kentucky Region during emergencies. Additionally, Judge Bertram said that potential economic benefits for the region over a 20 year period include \$259 million in additional gross business sales, \$83 million in additional household earnings, \$8.5 million in additional tax revenue to the region, and tourism and recreational benefits.

Representative McKee came to the table to speak further on the Lake Williamstown Expansion Project. He said that this project is the top priority project in his district and he supports the project.

In response to questions from Representative Wayne, Judge Bertram said that the watershed area will have its own zoning regulations, which will be different from what the counties have.

Representative Wayne expressed his concern about urban sprawl and the costs associated with sprawl. Judge Bertram said the project would promote smart growth and not urban sprawl.

In response to additional questions from Representative Wayne, Judge Bertram said the Corps of Engineers (Corps) began the study of the dam in 2004 and the money from the 2020 grant would be used to finalize the study. George Woolwine, HDR Engineering, Lexington, Kentucky, came to the table to further discuss the study. Mr. Woolwine said that the study showed very little impact on the current environment of the Lake. He said that the Corps has asked that the study look at replacing the dam in the future. Also, the Corps indicated that the Section 404 construction permit and the Section 401 water quality permit would need to be obtained before the Corps could review the study.

In response to questions from Senator Tori, Judge Bertram said that building a new dam would not have an economic impact and would cost about the same amount.

The study would take five years to complete. Judge Bertram said rate increases for customers have not been looked at yet.

Representative Wayne said that the 2020 program was developed to provide drinking water to areas of the state that are unserved. He asked why this project did not seek other sources of funding such as a Community Development Block Grant (CDBG). Judge Bertram said that they are not eligible for the CDBG based on median household income. Mr. Herald said that the reason the KIA Board approved this project was because of the regional concept. He also said that under KIA regulations, the project qualifies for the grant.

Senator Carroll made a motion to approve the 2020 grant for the City of Williamstown. The motion was seconded by Senator Tori. Six members voted affirmatively, one member voted “No.” The motion passed.

Ms. Williams indicated that various coal and tobacco development grants authorized by the General Assembly were included in members’ folders. Each project was authorized in a budget bill and no further Committee action was needed.

Representative Westrom called Katie Smith, Deputy Commissioner, Department of Financial Incentives, Cabinet for Economic Development to the table. Ms. Smith asked for the approval of a new Economic Development (EDB) grant for Simba USA, LLC (Simba) in Morehead, Kentucky. The loan amount is \$325,000 for five years with an interest rate of two percent to purchase equipment and software at the company’s golf towel manufacturing facility. In consideration of the loan, Simba has agreed to create 13 new full-time jobs for Kentucky residents within two years and maintain those jobs and its existing workforce of 12 employees for an additional year.

In response to questions from Representative Wayne, Ms. Smith said this is a loan and Simba will be repaying the loan. Ms. Smith also said that the company has an operation in Mexico and the company is currently in the process of negotiating new contracts that could potentially bring additional jobs to Kentucky.

Representative Rudy made a motion to approve the EDB grant to Simba. The motion was seconded by Senator Carroll and passed unanimously by roll call vote.

Next Representative Westrom called on Tom Howard, Executive Director, OFM, and Brett Antle, Deputy Director, OFM to discuss several items. Mr. Antle presented a new bond issue for Kentucky Housing Corporation (KHC) Single Family Housing Revenue Bonds Series 2009 B and C in an amount not to exceed \$150 million. Proceeds from this bond issue will provide financing for first-time and moderate income homebuyers.

Representative Damron asked if this new bond issue will be sold with bond insurance. Mr. Howard responded that KHC bonds are naturally AAA-rated.

Representative Damron thanked Mr. Howard for his follow-up report to the Committee concerning the Semi-Annual Report of the Kentucky Asset/Liability Commission. He asked Mr. Howard if all the bonds have been issued that were authorized in 2006. Mr. Howard said all the projects have access to funding. Mr. Howard also commented that the investment portfolio continues to make ample returns given the circumstances.

Representative Wayne made a motion to approve KHC Single Family Housing Revenue Bonds Series 2009 B and C. The motion was seconded by Representative Damron and passed unanimously by roll call vote.

Next Representative Westrom asked Rick McQuady, Chief Executive Officer, KHC to discuss the new KHC Mortgage Credit Certificate (MCC) program. Mr. McQuady said that as part of the Housing and Economic Recovery Act passed by Congress in July 2008, KHC received an additional \$110 million in private activity bond cap. KHC has developed a MCC program to assist homebuyers in Kentucky that will utilize a portion of its available bond cap. The MCC program will convert \$50 million of available bond cap to \$12.5 million of 25 percent MCCs. Under the MCC program, mortgage borrowers receive a 25 percent tax credit on the interest they pay on their mortgage loans over the life of the loans, up to \$2,000 and that any unused amounts could be carried forward.

In response to a question from Representative Wayne, Mr. McQuady said that it is a federal tax credit not a state tax credit.

In response to a question from Representative Westrom, Mr. McQuady said that a first-time homebuyer is defined as someone who has not owned a home in three years.

In response to a question from Senator Carroll, Mr. McQuady said the total outstanding bonded indebtedness for KHC is approximately \$2.3 billion. Mr. McQuady also said this is a statewide program and the program should be ready the first part of August.

Next, Mr. Antle provided four follow-up reports. The first report was for the Turnpike Authority of Kentucky Economic Development Road Revenue Bonds (Revitalization projects), 2009 Series A, in the amount of \$153,305,000. Proceeds from this bond issue will provide \$50 million of new money for highway projects and refund \$100 million of Kentucky Asset/Liability Commission Road Fund First Series A Project Notes that were issued to finance Road Fund supported projects. The second report was for the KHC Revenue Bonds 2009 Series A bond issue, in the amount of \$40,000,000.

Proceeds from this bond issue will fund mortgage loans for Kentucky residents by providing new money for KHC's mortgage purchase account and by refunding existing KHC debt. The third report was for Eastern Kentucky University General Receipts Bonds, 2009 Series, in the amount of \$12,095,000. Proceeds from this bond issue will provide financing for two projects: 1) Renovate Residence Hall – HB 406 (2008-10 Budget), and 2) Construct Intramural fields – HB 267 (2004-06 Budget). The last report was for Murray State University General Receipts Bonds, 2009 Series A, in the amount of \$7,665,000. Proceeds from this bond issue will provide financing for three projects authorized in HB 406 (2008-10 Budget): 1) New Residential College – Richmond Hall – additional; 2) Renovate Buildings; and 3) Complete Capital Renewal. No Committee action was needed.

Mr. Antle then reported two new bond issues with the School Facilities Construction Commission (SFCC) debt participation for Carter County and Campbell County.

Representative Wayne made a motion to approve the new SFCC bond issues. The motion was seconded by Senator Leeper and passed unanimously by roll call vote.

Representative Westrom asked Mr. Mullis to report the new local school district bond issues. Mr. Mullis said there were four school district bond issues with 100 percent local debt service support: Hardin County, Boone County, Laurel County, and Butler County. All disclosure information has been filed. No Committee action was required.

With there being no further business, Representative Wayne made a motion to adjourn the meeting. The motion was seconded and the meeting adjourned at 3:05p.m.